No. 08-1165

IN THE
Supreme Court of the United States

MARK LEVY, *Petitioner*,

v.

STERLING HOLDING COMPANY, LLC, ET AL., *Respondents*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

PAUL VIZCARRONDO, JR.
MICHAEL S. WINOGRAD
WACHTELL, LIPTON, ROSEN & KATZ
51 West 52nd Street
New York, NY 10019
(212) 403-1000

Counsel for Respondent National Semiconductor Corporation

STEVEN B. FEIRSON
Counsel of Record
CAROLYN H. FEENEY
JUSTIN C. DANILEWITZ
DECHERT LLP
Cira Centre
2929 Arch Street
Philadelphia, PA 19104
(215) 994-4000

G. ERIC BRUNSTAD, JR.
DECHERT LLP
90 State House Square
Hartford, CT 06103-3702
(860) 524-3960

Counsel for Respondent Sterling Holding Company, LLC

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QUESTIONS PRESENTED

1. Whether the Third Circuit correctly held, consistent with every other court to consider the issue, that Securities and Exchange Commission (SEC) Rule 16b-3(d), 17 C.F.R. § 240.16b-3(d), is a permissible construction of Section 16(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78p(b), and a valid exercise of the SEC's congressionally delegated authority.

2. Whether the Third Circuit correctly held, consistent with every other court to consider the issue, that applying Rule 16b-3(d), as amended in 2005, to a transaction predating the amendment did not have an impermissibly retroactive effect where: (a) the amendment clarified and resolved an ambiguity the Third Circuit expressly found in the prior version of the rule; (b) the resolution of ambiguity was consistent with both (i) the text of the prior version of the rule and (ii) SEC statements interpreting the prior version of the rule; and (c) application of the clarifying amendment raised no ex post facto concerns.

CORPORATE DISCLOSURE STATEMENT PURSUANT TO RULE 29.6

Respondent Sterling Holding Company, LLC (Sterling) is owned by Citicorp Venture Capital, Ltd., which is a wholly-owned subsidiary of Citibank N.A., which is a wholly-owned subsidiary of Citicorp Holdings, Inc., which is a wholly-owned subsidiary of Citigroup, Inc. Of Sterling's parent corporations, Citigroup, Inc. is the only publicly-held company.

Respondent National Semiconductor Corporation (National) has no parent corporations, nor does any publicly held corporation own 10 percent or more of National's stock.

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INTRODUCTION

The Third Circuit's unanimous decision to affirm an award of summary judgment in favor of Sterling and National is in accord not only with the rulings of every other court that has considered the same issues, but also with the relevant decisions of this Court. Levy's claims of "pervasive and deep splits" among the courts of appeals (Pet. at 1) and irreconcilable conflicts with this Court's precedents are invented out of whole cloth and do not withstand even superficial scrutiny.

Levy's petition seeks review of two aspects of the decision below. One is the Third Circuit's determination that amended Rule 16b-3(d) is a permissible construction of Section 16(b) and a valid exercise of the SEC's congressionally delegated authority to promulgate exemptive rules. This holding flowed from a straightforward application of *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Two other courts of appeals have considered the same challenges to the validity of Rule 16b-3(d) that Levy makes here. Both of them, applying *Chevron*, reached the same result as the Third Circuit. *See Roth ex rel. Beacon Power Corp. v. Perseus, L.L.C.*, 522 F.3d 242, 249 (2d Cir. 2008); *Dreiling v. Am. Express Co.*, 458 F.3d 942, 949-52 (9th Cir. 2006).

Levy also seeks review of the Third Circuit's determination that amended Rule 16b-3(d) simply clarified existing law, and therefore could be applied to exempt a transaction that predated the clarifying amendment. One other court of appeals has considered this question in connection with the clarifying amendments at issue in this case, albeit with respect to Rule 16b-7, 17 C.F.R. § 240.16b-7.[1] That court reached the same result as the Third Circuit in this case. *See Bruh v. Bessemer Venture Partners III L.P.*, 464 F.3d 202, 213 (2d Cir. 2006) ("[E]ven applying the prior Rule 16b-7, according to the Commission's reasonable interpretation, the transaction is exempt. Needless to say, where applying the old rule produces the same result as would the new rule, there is no impermissible retroactive effect."). Moreover, the Third Circuit's holding on this point is consistent with the relevant decisions of this Court. *See, e.g., Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982-86 (2005) (reversing the Ninth Circuit for applying a prior Ninth Circuit panel's interpretation of an ambiguous provision, rather than a subsequent agency clarification undertaken in response to the prior panel's interpretation); *Smiley v. Citibank, N.A.*, 517 U.S. 735, 744 n.3 (1996) ("Where . . . a court is addressing transactions that occurred at a time when there was no clear agency guidance, it would be absurd to ignore the agency's current authoritative pronouncement.").

In sum, the decision below is fully consistent with the decisions of other courts of appeals and with the jurisprudence of this Court. It presents only a mundane application of well-established principles. As a result, there is no reason for this Court's review, and the petition should be denied.

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[1] The SEC issued clarifying amendments to both Rule 16b-3 and Rule 16b-7 simultaneously.

STATEMENT OF THE CASE

1. Factual background. The transaction at issue in this case was a routine reclassification of all of the outstanding shares of preferred stock of nominal respondent Fairchild Semiconductor International, Inc. (Fairchild) into an equal value of shares of Fairchild's Class A common stock. The reclassification was nothing more than a standard corporate housekeeping chore undertaken by Fairchild in preparation for its initial public offering (IPO). Although Levy tries to characterize the reclassification as a "purchase," it was a corporate act that simply changed the form – and not the substance – of existing investments that had been made years before.

Fairchild was formed in March 1997 as a spin-off from National, which retained an approximately $12.8 million interest in the new corporation. Fairchild's only other initial equity investors were Sterling, which invested approximately $58.5 million, and key members of Fairchild's management, who invested approximately $6.5 million. In exchange for their investments, Sterling, National, and the management shareholders received a mix of Fairchild's three classes of equity: Class A common stock, Class B common stock, and preferred stock. Fairchild's board consisted of seven directors, including two designated by Sterling and one designated by National.[2]

By 1999, Fairchild desired to raise additional capital by selling 20 million new Class A shares to the public. In planning its IPO, Fairchild was told by every underwriter it interviewed to eliminate its preferred stock because the preferred stock's 12 percent dividend and liquidation preference would make Fairchild's common stock less marketable to potential investors.[3] Reclassifications of preferred stock into common stock are routine in preparation for IPOs. *See* Peter J. Romeo & Alan L. Dye, *Section 16 Securities Exchange Act of 1934: Insider Reporting and Short-Swing Liability* § 10.03[2][a] at 963 & n.14 (3d ed. 2008).

Fairchild's board of directors heeded the underwriters' advice. On July 14, 1999, it voted to restate Fairchild's certificate of incorporation to provide for the automatic reclassification of all

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[2] Levy's complaint alleged that both Sterling and National were directors by deputization because each had the right to appoint members of Fairchild's board. *See Blau v. Lehman*, 368 U.S. 403, 409-10 (1962) (shareholder who has the power to appoint one or more directors to the board of an issuer may in certain circumstances be considered a director by deputization).

[3] In a public stock offering, an underwriter typically purchases securities from the issuer and resells them to investors. *See* 15 U.S.C. §§ 78c(a)(20), 80b-2(a)(20); Black's Law Dictionary 1562 (8th ed. 2004) ("[U]nderwriter. 1. INSURER. 2. One who buys stock from the issuer with an intent to resell it to the public; a person or entity, esp. an investment banker, who guarantees the sale of newly issued securities by purchasing all or part of the shares for resale to the public.").

preferred stock into an equal value of Class A stock, and for the issuance of the new Class A shares to be sold in the IPO. These amendments to the certificate of incorporation required approval by a majority of each class of shareholders. Neither Sterling nor National alone had the power to deliver (or prevent) shareholder approval because neither owned a majority of every class of shares.[4] The requisite shareholder approvals were obtained on July 26, 1999.

On August 9, 1999, Fairchild filed its restated certificate with the Delaware Secretary of State. Under the terms of the restated certificate, all outstanding shares of preferred stock were automatically converted into the *equivalent value* of common shares using a fixed formula. The formula valued the preferred shares at their contractual liquidation value (which had been established in 1997); this consisted of their original cost plus accrued but unpaid dividends. The Class A common shares were valued at the price the company would receive for shares sold in the IPO; this price was determined by a third-party, the underwriter.[5] Thus, the value of Sterling and National's respective equity interests in Fairchild remained unchanged by the reclassification. The preferred stock ceased to

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[4] Neither National nor its designated director voted on the proposal.

[5] The petition erroneously states that the underwriter was "an affiliate of Sterling." (Pet. at 8.)

exist and automatically became Class A common stock of an equivalent value.[6]

On August 9, 1999, after filing its restated certificate of incorporation, Fairchild sold 20 million newly-issued Class A shares to its underwriter, marking the IPO's closing. In addition, one of the IPO underwriters exercised an option to buy 3 million of National's Class A shares.

In January 2000, Fairchild undertook another public offering of its Class A stock. Sterling sold approximately 11 million Class A shares in the secondary offering.[7] National sold all of its remaining Class A shares in the secondary offering, thereby liquidating its investment in Fairchild.

Discovery revealed no evidence suggesting that the reclassification and subsequent sale of shares in the secondary offering constituted short-swing profit-taking based on inside information. Sterling and National made no new investments in Fairchild at the time of the reclassification. Although the *form*

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[6] Under the conversion formula, Sterling's preferred shares became approximately 4 million shares of Class A common stock (prior to the reclassification, Sterling owned 14,212,000 Class A shares and 28,396,000 Class B shares, which were convertible into Class A on a 1:1 basis, for a total of approximately 42.5 million shares of common stock). National's preferred shares became slightly less than 900,000 shares of Class A common stock (prior to the reclassification, National held 8,115,000 Class A shares and 1,245,000 convertible Class B shares, for a total of approximately 9.4 million shares of common stock).

[7] Sterling did not need the reclassification in order to sell these shares in the secondary offering – it owned more than this number of Class A shares *before* the reclassification.

of their investments changed, the original investment decisions – including the amount of their investments – were made back in 1997. The reclassification operated formulaically to convert *all* outstanding preferred stock into Class A common stock. Shareholders exercised no discretion; all preferred shares were automatically reclassified into Class A common stock. The reclassification was a corporate act undertaken for a corporate purpose. It was approved by Fairchild's board and shareholders, after the underwriters recommended a reclassification to facilitate the IPO. Moreover, the reclassification, and indeed all material information about Fairchild, was disclosed in the IPO prospectus. Thus, there was never any imbalance of information between insiders and the investing public.

2. Background on rules at issue in the decision below. Rule 16b-3(d) exempts acquisitions of issuer equity securities by a director or officer of the issuer directly from the issuer when any one of three objective gate-keeping conditions is met. *See* 17 C.F.R. § 240.16b-3(d).[8] Those conditions include at least two that apply here: approval by the issuer's board of directors, and approval by a majority of the issuer's shareholders entitled to vote.

The rationale underlying Rule 16b-3 is that, based on the SEC's experience, transactions directly

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[8] "Rule 16b-3 is available to [a ten percent shareholder] who is also subject to section 16(b) by virtue of being an officer or director with respect to transactions with the issuer." *Ownership Reports and Trading by Officers, Directors, and Principal Security Holders*, Release Nos. 34-37260, 35-26524, 61 Fed. Reg. 30,376, 30,379 n.42 (June 14, 1996) (1996 Adopting Release).

between an issuer and its officers or directors "do not appear to present the same opportunities for insider profit on the basis of non-public information as do market transactions by officers and directors." *Ownership Reports and Trading by Officers, Directors, and Principal Security Holders*, Release Nos. 34-37260, 35-26524, 61 Fed. Reg. 30,376, 30,377 (June 14, 1996) (1996 Adopting Release); *see also Ownership Reports and Trading by Officers, Directors, and Principal Security Holders*, Release Nos. 33-8600, 34-52202, 35-28013, 70 Fed. Reg. 46,080, 46,083 (Aug. 9, 2005) (2005 Adopting Release) ("Typically, where the issuer, rather than the trading markets, is on the other side of an officer or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute."). The objective gate-keeping conditions specified in Rule 16b-3 provide assurance that the transaction will serve corporate purposes unrelated to potential speculative abuse. Thus, in the expert judgment of the SEC, "transactions between [an] issuer and its officers and directors . . . that satisfy other objective gate-keeping conditions, are not vehicles for the speculative abuse that section 16(b) was designed to prevent." 1996 Adopting Release, 61 Fed. Reg. at 30,377 (footnote omitted).

Rule 16b-7 exempts reclassifications, mergers, and consolidations where the companies involved have at least 85 percent cross-ownership.[9] This

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[9] A reclassification involves just one company; in effect, there is 100 percent cross-ownership.

exemption is targeted at transactions that change the form, but do not materially change the substance, of an insider's investment. The SEC has determined that such transactions "do not present insiders the significant opportunities to profit by advance information that Section 16(b) was designed to address," 2005 Adopting Release, 70 Fed. Reg. at 46,085, because they "do not involve a significant change in the issuer's business or assets," *id.* at 46,084, and "do not involve the holders' payment of consideration in addition to the reclassified class or series," *id.* at 46,085.

3. Procedural background. In November 2000, Levy filed a shareholder derivative suit alleging that the reclassification gave rise to a "purchase" by Sterling and National within the meaning of Section 16(b). The district court, upon motion by Sterling and National, dismissed the action on the ground that the transaction was exempt under Rules 16b-3(d) and/or 16b-7.

In 2002, the Third Circuit reversed the district court's dismissal of the case at the pleading stage. In doing so, the court of appeals identified several ambiguities in the then-existing versions of the rules and stressed the absence of sufficient guidance from the SEC. *See Levy v. Sterling Holding Co., LLC*, 314 F.3d 106 (3d Cir. 2002) (*Levy I*) (reproduced in App. at 63a-99a.)

With respect to Rule 16b-7, which was (and is) entitled "Mergers, reclassifications, and consolidations," the Third Circuit acknowledged that the rule was intended to exempt at least *some* reclassifications, but determined that the SEC had not made clear where or how to draw the line. (*See* App. at 77a ("[T]he rule must encompass *some* reclassifications."); *id.* at 71a ("[T]he SEC has not set forth its interpretation clearly."); *id.* at 74a ("[T]he title and text of the rule, standing alone, do not provide us assistance in our effort to ascertain the SEC's purpose."); *id.* at 77a (noting "the absence of specific SEC guidance about which reclassifications are exempt").)

With respect to Rule 16b-3(d), the court of appeals recognized that the language of the rule did not condition the availability of the exemption on the transaction at issue having a compensatory purpose. The court nevertheless viewed the 1996 adopting release as suggesting that the rule required some compensatory nexus. At the same time, however, the court acknowledged that the adopting release also contained a statement that "appear[ed] to cut against [that] position." (*Id.* at 98a.)[10] In the absence of further guidance from the SEC, the court of appeals declined to apply either exemption at the pleading stage. (*Id.* at 99a.)

Sterling and National filed a petition for rehearing, supported by the SEC as amicus curiae.

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[10] Prior to 1996, Rule 16b-3 applied only to certain transactions involving employee benefit plans. In 1996, however, the SEC drastically overhauled the rule, simplifying it and expanding its coverage in several important respects. The 1996 adopting release expressly stated that "unlike the [pre-1996 version of the rule], a transaction need not be pursuant to an employee benefit plan or any compensatory program to be exempt, nor need it specifically have a compensatory element." 1996 Adopting Release, 61 Fed. Reg. at 30,378-79.

With respect to Rule 16b-7, the SEC in its amicus brief explained that it had intended the exemption to apply to reclassifications on the same basis as mergers and consolidations, and that for all three types of transactions, the only condition for exemption was the only one set forth in the text of the rule: at least 85 percent cross-ownership among the companies involved. With respect to Rule 16b-3(d), the SEC confirmed that it had not intended to require a compensatory or other particular purpose; a transaction would be exempt so long as it met one of the conditions specified in the text of the rule, *e.g.*, board or shareholder approval. The SEC concluded that the Fairchild reclassification was exempt under both rules.

The court of appeals denied the petition for rehearing in a split vote. On remand, the parties conducted extensive discovery, at the conclusion of which Sterling, National, and Levy each moved for summary judgment. In June 2004, while the parties' cross-motions for summary judgment were pending, the SEC published proposed clarifying amendments to Rules 16b-3 and 16b-7, providing an opportunity for comment. In August 2005, the SEC adopted the clarifying amendments substantially in the form proposed. The adopting release reiterated that the amendments were intended *not* to make any substantive change, but rather to clarify the ambiguities identified in *Levy I*. *See* 2005 Adopting Release, 70 Fed. Reg. at 46,080.

In February 2007, the district court awarded summary judgment to Sterling and National. The district court held that the amended rules were permissible interpretations of Section 16(b) (*see* App.

at 38a-51a) and that they had no impermissibly retroactive effect (*see id.* at 52a-60a). As the district court explained, "the legal effect of the amended rules is the same as the legal effect of the pre-amendment rules." (*Id.* at 59a.)

In October 2008, the Third Circuit affirmed the district court's award of summary judgment in favor of Sterling and National. The court of appeals held that *Levy I*, which found both Rule 16b-3(d) and 16b-7 ambiguous, did not require the court to turn a blind eye to the SEC's subsequent clarifications of the rules' meaning. (*See id.* at 16a-20a.) The court of appeals also held that both rules fell within the SEC's express statutory authority to promulgate exemptions to Section 16(b). (*See id.* at 20a-25a.) Finally, the court of appeals held that amended Rule 16b-3(d) clarified existing law, and that the clarification was properly applied to the 1999 reclassification at issue here.[11] (*See id.* at 25a-31a.) With the reclassification exempted from the scope of Section 16(b), it could not constitute a "purchase" under the statute, and Levy's claim therefore necessarily failed.

REASONS FOR DENYING THE PETITION

There is no reason for review of the decision below. The Third Circuit held that Rule 16b-3(d) is a valid exercise of the SEC's express authority under

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[11] In affirming based on Rule 16b-3, the court of appeals "expresse[d] no opinion as to whether new Rule 16b-7 merely clarifies the old Rule or, relatedly, whether applying it here would have an impermissible retroactive effect." (App. at 31a.) Rule 16b-7 would, however, provide an alternative basis for the decision below.

Section 16(b) and that the SEC's clarifications of the rule's meaning were properly applied in this case. That decision is in accord with the decisions of every other court to consider the same issues, as well as with this Court's precedents. The decision below represents only a routine application of well-established principles. The petition should be denied.

I. THERE IS NO CONFLICT AMONG THE COURTS OF APPEALS.

There is complete *uniformity* among the courts of appeals with respect to the validity of Rule 16b-3 and the application of the SEC's clarifications to prior transactions. Two other courts of appeals have addressed the validity of Rule 16b-3 since the SEC clarified its meaning. Both of those courts, like the Third Circuit, found the rule to be a permissible construction of Section 16(b) and a valid exercise of the rulemaking authority Congress expressly delegated to the SEC. *See Roth*, 522 F.3d at 249; *Dreiling*, 458 F.3d at 949-52.[12]

There is likewise no split among the circuits on the question of whether the clarification reflected in amended Rule 16b-3(d) (as well as in the amicus briefs the SEC filed with the Third Circuit in this case) may be applied to transactions predating the clarification. While the Third Circuit is the only court of appeals that has addressed this issue with

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[12] At least one district court has also rejected a challenge to the validity of amended Rule 16b-3. *See Tinney v. Geneseo Commc'ns, Inc.*, 457 F. Supp. 2d 495, 503 (D. Del. 2006).

respect to Rule 16b-3,[13] one other court of appeals has addressed it with respect to Rule 16b-7, which the SEC clarified and amended simultaneously with Rule 16b-3. In *Bruh*, the Second Circuit concluded that it was proper to apply the SEC's construction of Rule 16b-7 – as expressed both in an amicus brief filed in *Bruh* and in the SEC's 2005 clarifying amendments to Rule 16b-7 – to a transaction that occurred in 2002. 464 F.3d at 213-14. The court reasoned that:

> [E]ven applying the prior Rule 16b-7, according to the Commission's reasonable interpretation, the transaction is exempt. Needless to say, where applying the old rule produces the same result as would the new rule, there is no impermissible retroactive effect.

Id. at 213.[14] *Bruh* involved a stock reclassification similar to the one at issue here. The Second Circuit's logic in *Bruh* fully comports with the Third Circuit's decision in this case.

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[13] The district court decisions that have addressed the question are consistent with the Third Circuit's holding. *See, e.g., Tinney*, 457 F. Supp. 2d at 505; *Segen v. CDR-Cookie Acquisitions, LLC*, No. 05 Civ. 3509, 2006 WL 59550, at *7 (S.D.N.Y. Jan. 4, 2006) ("Because [Rule 16b-3] is a clarification of pre-existing regulations, it has retroactive effect and applies to the transaction at issue in this case.").

[14] The Second Circuit explained that "we now have precisely what the Third Circuit lacked when conducting its inquiry in [*Levy I*]: the answer to whether 'the conversion of the preferred stock . . . [w]as the type of reclassification that the SEC would . . . have intended to exempt by Rule 16b-7.'" *Bruh*, 464 F.3d at 212-13.

Levy tries to manufacture three circuit splits, none of which withstand scrutiny:

1. Levy argues that there is now "a sharp split among courts of appeals on whether agency rules inconsistent with previous courts of appeals' decisions are necessarily retroactive as applied to pending claims." (Pet. at 13.) According to Levy, the D.C., Fourth, and Tenth Circuits are on one side of this divide, while the Third and Seventh Circuits are on the other. Examination of the cases he cites, however, demonstrates that the "sharp split" Levy posits does not exist.

Levy relies on *National Mining Association v. Department of Labor*, 292 F.3d 849 (D.C. Cir. 2002) (per curiam); *United States v. Capers*, 61 F.3d 1100 (4th Cir. 1995); and *United States v. Saucedo*, 950 F.2d 1508 (10th Cir. 1991). None of these cases, however, considered the issue the Third Circuit confronted in this case: whether amendments that merely clarify and resolve ambiguities in existing regulations, without raising ex post facto concerns, can be applied to pending claims. In *National Mining*, the D.C. Circuit stated that it would consider a new rule "impermissibly retroactive as applied to pending claims" only if it effects a substantive change "*and* is likely to increase liability." 292 F.3d at 860 (emphasis added).

The amendments at issue in both *Capers* and *Saucedo* conflicted with the *plain meaning* of the federal sentencing guidelines; there was no ambiguity for the amendments to resolve. *See Capers*, 61 F.3d at 1111 n.7 ("[W]e have before us an amendment that contravenes the plain meaning of the guideline."); *id.* at 1112 ("[T]he problem is that our [previous opinion] was based on the plain meaning of the term . . .; [it] did not say that the guideline was ambiguous."); *Saucedo*, 950 F.2d at 1512, 1516 (amendment at issue was inconsistent with prior judicial determination as to what "the plain language" of the guidelines required). The Third Circuit's own jurisprudence in this area likewise distinguishes between cases involving clarifying amendments to ambiguous regulations (*e.g.*, *United States v. Marmolejos*, 140 F.3d 488, 491 (3d Cir. 1998)) and those involving unambiguous provisions (*e.g.*, *United States v. Roberson*, 194 F.3d 408, 417-18 (3d Cir. 1999)). (*See also* App. at 29a n.11.)

This Court's decision in *National Cable & Telecommunications Association v. Brand X Internet Services* makes clear that this distinction is an important one. *See* 545 U.S. at 982. After *Brand X*, there can be no doubt that an appellate court's construction cannot foreclose a subsequent agency interpretation unless "the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Id.* Notably, all of the cases on which Levy relies in support of his purported circuit split predate *Brand X*.

2. Next, Levy claims that there is a difference of opinion among the circuits regarding whether a clarifying amendment is "categorically exempt from . . . retroactivity analysis." (Pet. at 16.) This argument mischaracterizes the decision below. The Third Circuit did *not* hold that any and all clarifying amendments should be applied retroactively,

regardless of their effect. On the contrary, it held only that amended Rule 16b-3 could properly be applied to the 1999 reclassification at issue in this case. In doing so, the Third Circuit expressly acknowledged that "when ex post facto issues are involved, the rules of the game are different." (App. at 29a n.11.)

Ex post facto issues were present in each of the Federal and D.C. Circuit cases on which Levy relies in support of his purported circuit split. In *Princess Cruises, Inc. v. United States*, 397 F.3d 1358 (Fed. Cir. 2005), the court held that a new evidentiary presumption could not be applied retroactively because it imposed liability on cruise lines without affording them notice to collect evidence necessary to rebut the presumption. *See* 397 F.3d at 1361, 1365-67. In *National Mining*, the court stated that it would consider a new rule "impermissibly retroactive as applied to pending claims" only if it effects a substantive change "*and* is likely to increase liability." 292 F.3d at 860 (emphasis added); *see also Marrie v. SEC*, 374 F.3d 1196, 1207-08 (D.C. Cir. 2004) (revised rule could not be applied to prior conduct because it imposed new sanctions by eliminating defenses, including good faith, that were available under the prior rule and may have been relied on). Because amended Rule 16b-3 does not increase Sterling and National's liability, this case does not implicate ex post facto concerns.

3. Finally, Levy argues that there is a split among the courts of appeals as to whether a rule's status as "legislative" or "interpretive" has any bearing on whether it may be applied retroactively. In doing so, he plays semantic games. He ignores

the fact that the term "legislative" is sometimes used to denote rules that must comply with the procedural requirements of the Administrative Procedure Act (APA), 5 U.S.C. § 551 *et seq.*, and sometimes used to denote substantive changes. While these two uses may overlap, they are not co-extensive.

The Seventh Circuit's decision in *First National Bank of Chicago v. Standard Bank & Trust*, 172 F.3d 472 (7th Cir. 1999), which Levy cites, illustrates this point. In that case, the Seventh Circuit considered a clarifying amendment to a Federal Reserve Board regulation. The Seventh Circuit described its task as "review[ing] the regulatory record to confirm that [the amendment] was a clarification of the law, and not a substantive change." 172 F.3d at 479. The plaintiff argued that the amendment "must be legislative," *i.e.* substantive, because it changed the language of the rule, and because the amendment was adopted through the APA's formal rulemaking procedures. *Id.* The Seventh Circuit rejected both arguments, noting that "'[n]ew language need not imply new substance'" and that "once a regulation is adopted by notice-and-comment rulemaking . . . its text may only be changed in the same manner." *Id.* The court concluded that the clarifying amendment could be applied retroactively. *Id.* at 479-80; *see also id.* at 478 n.7 (stating that "*Landgraf* in no way undercuts" the principle "that we defer to an agency's clarifying/legislative classification, and that clarifying amendments may have retroactive effect"). Thus, far from creating a circuit split, *First National* is entirely *consistent* with the decision below.

The other case Levy cites is no more helpful to his cause. In *Health Insurance Association of America, Inc. v. Shalala*, 23 F.3d 412 (D.C. Cir. 1994), the D.C. Circuit *rejected* a suggestion that it should distinguish between interpretive and legislative rules for purposes of retroactivity analysis. 23 F.3d at 422-23. That conclusion is consistent with the Third Circuit's statement that "the legislative-interpretive dichotomy has no bearing on whether a rule has an impermissible retroactive effect." (App. at 28a n.10.)[15]

II. THE DECISION BELOW IS CONSISTENT WITH THE RELEVANT DECISIONS OF THIS COURT.

In addition to being in accord with the decisions of every other court that has examined the validity of amended Rule 16b-3 and its applicability to transactions predating the clarification of the rule, the decision below is also entirely consistent with this Court's jurisprudence.

A. The Third Circuit Held Correctly That Rule 16b-3(d) Passes Muster Under *Chevron*.

The Third Circuit's determination that amended Rule 16b-3(d) is a valid exercise of the SEC's authority under Section 16(b) was a straightforward

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[15] Levy's observation that in *Health Insurance Association of America* "the D.C. Circuit . . . applied the rubric of *American Mining Congress v. Mine Safety & Health Administration*, 995 F.2d 1106, 1109-10 (D.C. Cir. 1993)," (Pet. at 19) is neither here nor there. *American Mining Congress* had nothing at all to do with retroactivity and consequently did not even mention the issue.

application of the principles set forth in *Chevron*. In that case, this Court held that an agency regulation promulgated pursuant to an express statutory grant of authority is subject to challenge only if it is "arbitrary, capricious, or manifestly contrary to the statute." 467 U.S. at 844.

Section 16(b) expressly states that it "shall not be construed to cover . . . any transaction or transactions which the [SEC] by rules and regulations may exempt as not comprehended within the purpose of this subsection."[16] 15 U.S.C. § 78p(b). Because of this express statutory delegation of authority to the SEC, "*Chevron* deference clearly applies" to the agency's exemptive rules. (App. at 22a.) The decision below correctly held that the statutory interpretation embodied in amended Rule 16b-3(d) "easily pass[es] muster under [*Chevron*'s] lenient standard." (*Id.* at 21a.) As the court of appeals explained:

> [T]he purchase of securities from, or sale of securities to, the issuer by a director or officer does not present the same informational asymmetry, and associated opportunity for speculative abuse, that, according to the Supreme Court, Congress was targeting in

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[16] The Third Circuit did not hold, as Levy suggests, that the SEC has "plenary authority" to promulgate whatever exemptions it wishes. (Pet. at 26.) On the contrary, the Third Circuit, applying *Chevron*, asked "whether it was reasonable for the SEC to think that the transactions exempted by [amended Rule 16b-3] are 'not comprehended within the purpose' of section 16(b)." (App. at 22a.) As noted below, it appropriately concluded that it was "perfectly reasonable" for the SEC to reach that conclusion. (*Id.* at 23a-24a.)

> enacting section 16(b). Because this rationale is perfectly reasonable – and applies equally whether or not the transaction has a compensatory nexus – we conclude that new Rule 16b-3 is a permissible construction of section 16(b) and a valid exercise of the SEC's congressionally delegated authority.

(*Id.* at 23-24a.)

Levy's erroneous argument to the contrary is based on the untenable premise that Section 16(b) is intended to "ban[] *all* short-swing trades by insiders." (Pet. at 28 (emphasis in original).) Although his petition repeats this assertion over and over again,[17] it remains wrong. Indeed, Levy's position is flatly inconsistent with the language and

[17] (*See, e.g.*, Pet. at 26 ("Congress intended Section 16(b) broadly to prevent *all* profiteering from short-swing transactions." (emphasis added)); *id.* at 27 ("Section 16(b) is noteworthy for its rigidity and the fact that it left virtually *no room* for interpretation or interference by the SEC." (emphasis added)); *id.* at 29 ("Section 16(b)'s 'purpose' is to prevent short-swing trading, writ large, by insiders."); *id.* at 30 ("Section 16(b)'s 'purpose' is to prevent *any* profiteering on short-swing transactions." (emphasis added)); *id.* at 30-31 ("Congress intended for Section 16(b) to cover the conduct at issue here: short-swing trading by an insider."); *id.* at 31 n.5 ("Section 16(b)'s primary purpose is . . . to promote market stability by banning profiteering from *all* short-swing transactions." (emphasis added)).) The amicus brief of the National Conference on Public Employee Retirement Systems (NCPERS) merely echoes these erroneous assertions. *See* Brief of the National Conference on Public Employee Retirement Systems as Amicus Curiae in Support of Petitioner (Amicus Br.). It is thus doubtful whether that brief "brings to the attention of the Court relevant matter not already brought to its attention by the parties." Sup. Ct. R. 37.1.

legislative history of Section 16(b), as well as with the relevant decisions of this Court.

The Senate Committee's report accompanying the bill that became Section 16(b) explained that it was intended to protect the public by preventing insiders "from speculating in the stock *on the basis of information not available to others.*" S. Rep. No. 73-792, 73d Cong., 2d Sess., at 9 (1934) (emphasis added). This Court recognized this purpose more than thirty years ago:

> The general purpose of Congress in enacting § 16(b) is well-known. Congress recognized that insiders may have access to information about their corporations *not available to the rest of the investing public.* By trading on this information, these persons could reap profits *at the expense of less well informed investors.*

Foremost-McKesson, Inc. v. Provident Secs. Co., 423 U.S. 232, 243 (1976) (emphasis added; citation omitted); *accord Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 592-93 & n.23 (1973). Thus, the purpose of Section 16(b) was not to prevent *all* short-swing trading by insiders, as Levy mistakenly contends, but rather to prevent insiders with non-public information from using that information to obtain a speculative profit at the expense of less-informed market participants. (*See* App. at 22a ("[S]ection 16(b)'s self-proclaimed purpose is 'preventing the *unfair* use of information which may have been obtained by [a ten percent shareholder], director, or officer by reason of his relationship to the issuer.'") (quoting 15 U.S.C. § 78p(b); emphasis added).)

The method Congress chose to accomplish this purpose was to create a broad statutory prohibition against short-swing insider trades *and* to couple that prohibition with a broad grant of authority to the SEC to use its expertise to develop appropriate exemptive rules. Thus:

> In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect.

Reliance Elec. Co. v. Emerson Elec. Co., 404 U.S. 418, 422 (1972) (citation and quotation marks omitted). At the same time, however, Congress recognized that Section 16(b)'s "crude rule of thumb," *Kern County*, 411 U.S. at 592 n.23, would sweep too broadly if applied without exception. Thus, the statute itself contains two exemptions, and Congress also authorized the SEC to employ its expertise to promulgate rules exempting additional classes of transactions "not comprehended within the purpose of" the statute.[18] 15 U.S.C. § 78p(b).

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[18] Levy's position – "that Section 16(b)'s 'purpose' is to prevent any profiteering on short-swing transactions" (Pet. at 30), so that an exemption must be invalid if it allows *any*

In sum, although Congress designed the statute to apply crudely to a very broad "'class of transactions in which the possibility of abuse was believed to be intolerably great,'" *Kern County*, 411 U.S. at 592, it also expressly authorized the SEC to exempt classes of transactions that – in the expert judgment of the SEC – did not present significant opportunities for speculative abuse. That is precisely what the SEC did in adopting Rule 16b-3(d). Levy is essentially asking this Court to second-guess the SEC's congressionally mandated expert judgment that Rule 16b-3(d) exempts classes of transactions that do not present an "intolerably great" risk of the sort of speculative abuse that Section 16(b) was designed to prevent. *Reliance Elec.*, 404 U.S. at 422. The decision below, however,

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(Cont'd)
"short-swing trading by an insider" (*id.* at 31) – would read out of Section 16(b) the exemptions contained in the statute itself, as well as the congressional delegation of authority to the SEC to promulgate additional exemptive rules. Furthermore, his position is irreconcilable with this Court's precedents. For example, this Court has fashioned an entire doctrine – the so-called "unorthodox transaction" doctrine – to exempt from Section 16(b) short-swing insider transactions that fall within the literal reach of the statute but nevertheless do not give rise to the potential for the type of speculative abuse that Congress enacted Section 16(b) to prevent. *See Kern County*, 411 U.S. at 593. As this Court explained in *Kern County*, it is the "unfair use of information" to engage in "shortswing speculation" to the disadvantage of the public that Section 16(b) was designed to prevent. *Id.* at 591. The unorthodox transaction doctrine is another alternative ground that the district court could have used to award summary judgment to Sterling and National in this case. The court of appeals did not address this issue because its "analysis of Rules 16b-3 and 16b-7 . . . [made] it unnecessary for [it] to do so." (App. at 6a n.3.)

faithfully followed this Court's precedents. The Third Circuit properly applied *Chevron* in rejecting Levy's challenge to the validity of the rule. (*See* App. at 20a-25a; *accord Dreiling*, 458 F.3d at 952; *Roth*, 522 F.3d at 248-49.)[19]

B. The Third Circuit Held Correctly That The Clarification Embodied In Amended Rule 16b-3(d) Should Be Applied In This Case.

1. An agency's clarification of its own regulation deserves deference.

This Court's precedents also demonstrate that courts cannot turn a blind eye to agency clarifications of ambiguous regulations. For example, in *Auer v. Robbins*, this Court deferred to the Department of Labor's interpretation of its own ambiguous regulation. 519 U.S. 452, 461-63 (1997). The interpretation was expressed in an amicus brief, which necessarily postdated the events giving rise to that lawsuit. *Id.*

More recently, in *Brand X*, this Court reversed the Ninth Circuit for applying a prior Ninth Circuit

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[19] The transactions that Rule 16b-3(d) exempts do not "threaten[ ] the financial security of the underlying assets of public employee retirement systems," or "threaten[ ] the financial security of 25 million Americans," as amicus curiae NCPERS suggests. (Amicus Br. at 6.) Contrary to NCPERS's assumptions, in the expert judgment of the SEC, any profits obtained from transactions directly between issuers and their directors or officers typically are not "to the detriment of other shareholders." (*Id.*) The SEC's views in this regard are entitled to deference.

panel's interpretation of an ambiguous provision, rather than a subsequent agency clarification issued in response to that prior Ninth Circuit decision. *See* 545 U.S. at 982. The Court explained that:

> A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference *only if* the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion.

Id. (emphasis added); *accord Smiley*, 517 U.S. at 744 n.3 (1996) ("Where . . . a court is addressing transactions that occurred at a time when there was no clear agency guidance, it would be absurd to ignore the agency's current authoritative pronouncement."); *Stinson v. United States*, 508 U.S. 36, 46 (1993) ("[P]rior judicial constructions of a particular guideline cannot prevent the Commission from adopting a conflicting interpretation that satisfies the standard we set forth today.").

Brand X involved an agency interpretation of an ambiguous statute; however, the same rationale applies with even greater force to an agency clarification of its own ambiguous regulation. "When the construction of an administrative regulation rather than a statute is in issue, deference is even more clearly in order." *Udall v. Tallman*, 380 U.S. 1, 16 (1965). An agency's interpretation of its own regulation is accorded "controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945); *accord Auer*, 519 U.S. at 457.

Here, in *Levy I*, a Third Circuit panel attempted to interpret what it found to be an ambiguous rule. As the decision below explained:

> In *Levy I*, we did not conclude that section 16(b) unambiguously precluded the SEC from exempting transactions like the 1999 reclassification. Similarly, we did not indicate that our reading of old Rule 16b-3 . . . flowed unambiguously from [its] terms. Indeed, we struggled to divine [its] applicability to the instant fact pattern. With respect to Rule 16b-3, we concluded only that "the weight of the SEC's pronouncements . . . *suggest[ed]*" that we should read in a compensatory nexus requirement. *Levy I*, 314 F.3d at 124 (emphasis added). Further, we recognized that a portion of the SEC's adopting release "appear[ed] to cut against" this interpretation. *Id.*

(App. at 20a.) In response to *Levy I*, the SEC issued the clarifying amendments at issue here. The Third Circuit then did precisely as this Court has instructed: it followed the SEC's guidance.

2. The general presumption against retroactivity does not apply to clarifications.

The general presumption against retroactive rulemaking discussed in *Bowen v. Georgetown University Hospital*, 488 U.S. 204 (1988), does not apply to clarifications. *See Smiley*, 517 U.S. at 744 n.3 (distinguishing between clarification and substantive change in agency position, and noting that only the latter would implicate *Bowen*'s concerns about retroactive application).[20] Where an amendment just "point[s] the way, for the first time, for correctly applying the antecedent [provision] to a situation which arose under [it]," the amendment "is no more retroactive in its operation than is a judicial determination construing and applying a statute to a case in hand." *Manhattan Gen'l Equip. Co. v. Comm'r*, 297 U.S. 129, 135 (1936); *see also Long Island Care at Home, Ltd. v. Coke*, 127 S. Ct. 2339, 2345-50 (2007) (ruling that 2005 clarification of earlier regulation applied to pre-2002 conduct).

Moreover, absent ex post facto concerns, even a substantive change may properly be given retroactive effect. As this Court has made clear, applying substantively new law to prior conduct does not pose a problem unless the change "would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994) (new statute at issue could not be applied retroactively because it would have imposed damages liability for past conduct); *accord Hamdan v. Rumsfeld*, 548 U.S. 557, 577 (2006).

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[20] *Bowen* itself involved a substantive change in the law, not a clarifying amendment to an ambiguous regulation. The same is true of *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), which Levy cites repeatedly in his petition. Indeed, *Landgraf* involved provisions of the Civil Rights Act of 1991 that caused "'a seachange in employer liability for Title VII violations.'" 511 U.S. at 249 (quoting *Landgraf v. USI Film Prods.*, 968 F.2d 427, 433 (5th Cir. 1992)).

In the context of this case, even if amended Rule 16b-3(d) *were* a substantive change (which it is not), applying the change here still would not run afoul of *Bowen* and *Landgraf*. The amended rule does not impose any additional burdens on directors, officers, or principal shareholders for already-completed transactions; on the contrary, it only *reduces* the burden on past transactions.[21]

*   *   *

The Third Circuit in this case corrected its own prior decision, which was based on what it had expressly found to be an ambiguous rule, in order to conform to the SEC's subsequent guidance. Its decisions to uphold the validity of amended Rule 16b-3(d) and to apply the clarifications reflected in the amended rule to this pending case are consistent with the decisions of all other courts of appeals that have addressed the same issues, as well as with the relevant prior decisions of this Court. There is no circuit split or conflict with this Court's jurisprudence, and therefore no reason for this Court's review.

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[21] It is farfetched for Levy to suggest that he developed "settled expectations," *Landgraf*, 511 U.S. at 265, on the basis of an intermediate appellate court's ruling (at the pleading stage of the case) that it could not discern the SEC's intention as to the scope of Rule 16b-3(d). Moreover, the relevant inquiry under the first prong of the *Landgraf* test is whether retroactive application of a provision "would impair rights a party possessed *when he acted*." *Id.* at 280.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

STEVEN B. FEIRSON
Counsel of Record
CAROLYN H. FEENEY
JUSTIN C. DANILEWITZ
DECHERT LLP
Cira Centre
2929 Arch Street
Philadelphia, PA 19104
(215) 994-4000

G. ERIC BRUNSTAD, JR.
DECHERT LLP
90 State House Square
Hartford, CT 06103-3702
(860) 524-3960
Counsel for Respondent Sterling Holding Company, LLC

PAUL VIZCARRONDO, JR.
MICHAEL S. WINOGRAD
WACHTELL, LIPTON, ROSEN & KATZ
51 West 52nd Street
New York, NY 10019
(212) 403-1000

Counsel for Respondent National Semiconductor Corporation

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